

A Review of the Principle of Good Faith in English Contract Law

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Abstract

Today, the question of “*Is there a duty to negotiate in good faith?*” still arises in most of the jurisdictions that practice English Law. This paper reviews the principle of good faith in English contract law to provide an insight of how the UK courts make judgment decisions. The main reference case to support this research paper is *Walford v Miles* which had been cited by many jurisdictions for their previous court decisions. Other sources of references were derived from legal journal articles and books. In the discussion, there were findings both supporting and rejecting the “agreement to agree”. However, the final outcome of the analysis revealed that a more explicit definition by the UK law is required to end the debate on the principle vagueness.

Keywords: Good faith, Certainty, Fixed period, Agreement to agree, ‘Lock-out’.

Introduction

In the civilized world as early as the 19th century, people could engage in commerce with minimum restrictions and the law of contract under the English legal system also allows people to have freedom of contract. According to Sir George Jessel in *Printing and Numerical Registering Co. v Sampson* [1] that: “*If there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty in contracting, and that their contracts, when entered freely and voluntarily, shall be held sacred and shall be enforced by the Courts of Justice.*” [2].

While there is freedom to contract, Applebey argues that the underlying legal protection of contract law for contracting parties among others are reasonableness, equality of bargaining power and fairness. He stated that “*As an antidote to the equitable notion of fairness, the common law perceived certainty as a key objective of contract law*” [3]. Nevertheless, contract law is not the main source of law for contracting obligations. Contract, tort, and restitution exist side by side which is often overlaps.

Lord Roskill also viewed certainty importantly. He said: “*First that law should be certain. Secondly, whilst being certain it must be adaptable to the*

changing needs of the particular period. Those two principles are not contradictory. On the contrary, they are complementary. As to the first, business men make their contracts by reference to certain legal rules. Those rules must be certain.” [4].

Applebey further stressed on the importance of good faith for contract law which is equivalent of equity and reasonableness and much more [5].

What is Good Faith?

Good faith in contract law is a very subjective legal statement which leads to various theoretical definitions. Juenger ever quoted, “*the term.....lacks a fixed meaning.....because [it] is loose and amorphous.*” [6]. At the same tone, Powers described good faith as “*an elusive term best left to lawyers and judges to define over a period of time as circumstances require.*” [7].

On the other hand, a more serious note on good faith by O’Connor is: “*A fundamental principle derived from the rule pacta sunt servanda, and other legal rules, distinctively and directly related to honesty, fairness and reasonableness, the application of which is determined at a particular time by the standards of honesty, fairness and reasonableness prevailing in the community which are considered appropriate*

for formulation in new or revised legal rules.” [8].

Good faith is essential for contract law in the European civil law systems [9]. It applies to United States (US), Canada and many other jurisdictions as well. However, it is not recognised in the English Common Law.

Although the concept of good faith already existed since the development of Roman Law [10], the concept of good faith as an implied principle in the performance of contracts being adopted later in the eleventh and twelfth centuries throughout civil law regimes [11] particularly in England. The importance of good faith concept was then expanded into common law whereby in 1766, Lord Mansfield refer good faith as *“the governing principle.....applicable to all contracts and dealings”* [12].

Meanwhile in the modern world of civil law, Bingham L.J. further commented good faith concept as follow:

“In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as ‘playing fair’, ‘coming clean’ or ‘putting one’s cards face upwards on the table’. It is in essence a principle of fair and open dealing.” [13].

Later, in 1989 the Court of Appeal supported Bingham L.J.’s decision in *Interfoto Picture Library v Stilleto Visual Programmes* [14] that the following three key elements of good faith is applicable in protecting the contracting parties:

- i. Promotion of fair and open dealing
- ii. Prevention of unfair surprise
- iii. Absence of real choice

It is a well established principle that English Courts will try their best to enforce contracts between parties so as to avoid being coined as the ‘destroyer of bargain’ [15]. However, the judges must be able to clarify the objectivity and certainty of an agreement at least in the eyes of a reasonable man.

Good faith is indeed important [16] for contract law as what Tetley agreed that the application of good faith is priority for contract

formation and performance and also necessary during the enforcement of a contract [17].

The Walford Case [18]:

“The defendants, owners of a company, were negotiating for the sale of the company to the plaintiffs. On 17 March 1987, they had entered into an agreement whereby in return for the provision of a comfort letter from the plaintiffs’ bank (indicating that loan facilities had been granted to cover the price of £2m), the defendants agreed to terminate any negotiations with third parties, not to entertain offers from any other prospective purchasers and to deal exclusively with the plaintiffs. Although the plaintiffs complied with their side of the agreement, the defendants withdrew from the negotiations and decided to sell to third party. The plaintiffs claimed damages for breach of this collateral agreement, which arguably was both a lock-out and lock-in agreement. The Court of Appeal held that the collateral agreement alleged was only an agreement to negotiate and was therefore unenforceable. The plaintiffs appealed. Held (dismissing the appeal): although lock-out agreement (not to negotiate with any other person) could be enforceable if it was made for good consideration and covered a fixed period of time, where, as here, it covered an unspecified period of time it was unenforceable. There could be no implied term to negotiate in good faith for a reasonable period of time.”

There are two legal issues that formed the final House of Lord’s decision that is there were no ‘fixed period’ and ‘consideration’ for negotiation in the “lock-out” agreement. Walford’s appeal was dismissed because he failed to provide express terms and the determined duration to finalise the negotiation.

Lord Ackner gave a precise comment, *“The reason why an agreement to negotiate, like an agreement to agree, is unenforceable is simply because it lacks the necessary certainty”* [19] Further, Lord Ackner noted:

“A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party. It is here that the uncertainty lies. In my judgment, while negotiations are in existence either party is entitled to withdraw from these negotiations, at any time and for any reasons. There can thus be no obligation to continue to negotiate until there is a ‘proper reason’ to withdraw. Accordingly, a bare agreement to negotiate has no legal content.” [20].

So, what Ackner argued above was that there is no solid 'consideration' to justify the continued negotiation especially without specific duration to last. When there is no solid consideration and fixed duration it makes the agreement to negotiate uncertain. In turn, uncertainty gives no obligation to any contracting parties in an agreement.

In the Court of Appeal [21] a very clear judgment was made by Bingham L.J. that the courts would stand firmly not to recognise any provision for uncertainty especially for commercial practices. He looked at the "lock-out" agreement between contracting parties is a separate undertaking which was not part of the process during negotiation to enforce a contract. Rather it is only just related machinery for conducting the negotiations. Therefore, a 'lock-out' agreement is a negative agreement, whereby one contacting party promises another party that he or she will not negotiate, for a fixed period, with any third party. His Lordship commented that:

"If any obligation by either party to negotiate is disregarded as legally ineffective, there remains a clear undertaking by Mr. Miles on behalf of himself and his wife, conditional on timely production of a comfort letter, not to deal with any party other than the plaintiffs and not to entertain any alternative proposal. If this undertaking was supported by consideration moving from the plaintiffs as promisees and was sufficiently certain to be given legal effect, I see no reason why it should not form part of a legally enforceable contract." [22].

Although no time limit was mentioned for this "lock-out", Bingham L.J. opined that there were no obstacles for the agreement to remain in force for a reasonable time which would end if the parties reached "a genuine impasse." Based on the facts, he rejected the defendants' reasons for terminating the negotiations (which were never informed to the plaintiffs) could be considered as an impasse bringing the plaintiffs' period of exclusivity to an end.

The rationale is to encourage the contracting parties to a duty to negotiate in good faith but Bingham L.J. did not see this as a challenge "*since it is without doubt what the parties intended should happen.*"[23]. Therefore, he was unable to accept the 'agreement to agree' become a valid contract to negotiate in good faith. Nevertheless, he acknowledged the difficulties inherent in enforcing such a contract which he didn't rule out such a concept were impossible. His

Lordship continued:

"If such a contract were recognised, breach could not of course be demonstrated merely by showing a failure to agree, and if negotiations were shown to have broken down it might be necessary for the court to decide whether the parties had reached a genuine impasse or whether one or the other party had for whatever ulterior reason aborted the negotiation. This could be hard to decide, but no harder than other matters which regularly fall for judicial decision." [24].

When the House of Lords dismissed the appeal [25], it differentiated between a "lock-in" and "lock-out" agreements that the former is an attempt to make one party negotiate exclusively with another person whilst is an undertaking not to negotiate with a third party and under special circumstances, it can be enforceable. In other words, a negative "lock-out" arrangement could be enforceable if it expressed with terms and fixed duration of the "lock-out" and was supported by consideration. However, the parties could never be "locked-in" to positive negotiations by such a contract as it would generate uncertainty and leads to unenforceable contract to negotiate. Moreover, there could be no implied term to negotiate positively in supporting for a reasonable period of time in a "lock-out" contract. Lord Ackner strongly debated that an 'agreement to agree' was not recognised in English Contract Law. That means the contracting parties concerned have no obligations to finalise a contract as well as to determine when to end the bargaining.

In addition, he challenged that how could the court to police such an 'agreement'? As such he rejected outright the possibility of good faith being an important principle for contract negotiations. His Lordship argued:

"How can a court be expected to decide whether, subjectively, a proper reason existed for the termination of negotiations? The answer suggested depends upon whether the negotiations have been determined 'in good faith.' However, the concept of a duty to carry on negotiations in good faith is inherently repugnant to the adversarial position of the parties when involved in negotiations. Each party to the negotiations is entitled to pursue his (or her) own interest, so long as he avoids making misrepresentations. To advance that interest he must be entitled, if he thinks it appropriate, to threaten to withdraw from further negotiations or to withdraw in fact in the hope that the opposite party may seek to reopen the negotiations by offering him

improved terms A duty to negotiate in good faith is as unworkable in practice as it is inherently inconsistent with the position of a negotiating party." [26].

The final judgment from the House of Lords is preferable to that of the Court of Appeal because the uncertainty of express terms and without fixed period in the "lock-out" agreement. The decision is to protect contracting parties in exercising "Bad Faith" practices under any ingenuine, unfair, unreasonableness negotiation. Thus *Walford* outcome served as a Doctrine of Good Faith in English contract law or a precedent case for future court reference.

Analysis

Obviously, English Contract Law rejected "agreement to agree" which is not enforceable. It was earlier recognised by Lord Denning in *Courtney & Fairbairn Ltd v Tolaini Bros (hotels) Ltd* [27]:

"If the law does not recognise a contract to enter into a contract (when there is a fundamental term yet to be agreed) it seems to me that it cannot recognise a contract to negotiate. The reason is because it is too uncertain to have any binding force. It seems to me that a contract to negotiate, like a contract to enter into a contract, is not a contract known to the law." [28].

Hence, *Courtney* and *Walford* cases became a common law reference. The reason English Contract Law doesn't accept 'Duty to Negotiate in Good Faith' directly mainly due to the fundamental principle of certainty. Certainty is the main requirement for contract formation as depicted in *Loftus v Robert* [29]. Furthermore, the agreement to negotiate also contradicts to the freedom to contract.

However, many judges didn't reject 'Duty to Negotiate in Good Faith' entirely. For instance Lord Denning commented a contract is unenforceable only when it lacks both certainty and incompleteness. A similar "lock-out" agreement justified with "Certainty" is in *Pitt v PHH Asset Management Ltd* [30]. On the other hand, Lord Ackner did support duty of good faith when "use of best endeavours" in *Channel Home Centers, Division of Grace Retail Corp. V Grossman* [31].

Another recent case which support to the above arguments is in *Petromec v Petroleo Brasileiro SA Petrobas* [32]. The Court of Appeal claimed that the agreement was legally enforceable and held that the express

obligation to negotiate the additional costs in good faith was not a bare agreement to negotiate. Lord Justice Longmore said:

"It would be a strong thing to declare unenforceable a clause into which the parties have deliberately and expressly entered" [33].

Although the decision made by Longmore LJ in the *Petromec* case is non-binding, many researchers argued in favour of the need for such a flexibility enforceable 'express' obligation to negotiate in good faith as long as there is a detail written contract produced by professional lawyers.

For instance, Friedman and Wilcox commented:

"...is an interesting case because, contrary to the traditional view, it suggests that there are certain situations where an agreement to negotiate in good faith may be enforceable" [34].

They further suggested that the rule of good faith should be adopted by the courts in order to provide clearer stance between the contracting parties for binding a negotiation [35].

Notwithstanding to the above, the challenges of the principle of good faith can be further cross examined in other jurisdictions.

The Australian Law shares the same English Common Law heritage but is moving towards the European and United States approach more recently [36]. In 1991, an interesting debate was found in *Coal Cliff Collieries Pty Ltd. v Sijehama Pty Ltd* [37]. Despite the final decision was in line with *Walford* case judgment but there were contradict views on the principle of good faith by three different judges. Both Kirby P and Waddell A-JA agreed that it was possible that an agreement to negotiate may be enforceable in certain circumstances whilst Handley A-JA, claimed the opposite is true which he noted, *"a promise to negotiate in good faith is illusory and therefore cannot be binding"* [38].

Meanwhile in US, although the American law recognize good faith but it is not fall under the common law instead is found in statute under sect. 1-203 of the Uniform Commercial Code (UCC). It stated that *"[e]very contract or duty within this Act imposes an obligation of good faith in its performance of enforcement."* [39]. However, Coyne and Evans said that not all the US 50 states jurisdictions are adopting this statute for their practice [40].

Based on the above jurisdictions comparison, it is claimed that there were inconsistency found in various court decisions when interpreting the principle of good faith under English Law. Nevertheless, it is part of the English Contract Law where piecemeal solution is applied for different circumstances. In *Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd* [41]. Bingham L.J. observed:

“English Law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness. Many examples could be given. Thus equity has intervened to strike down unconscionable bargains. Parliament has stepped in to regulate the imposition of exemption clauses and the form of certain hire-purchase agreements. The common law also has made its contribution by holding that certain classes of contract require the utmost good faith, by treating as irrecoverable what purport to be agreed estimates of damage but are in truth a disguised penalty for breach, and in many other ways.” [42].

In addition Bradgate R. commented, *“Among the many other “piecemeal solutions” which English courts have used to police the fairness of contracts and their performance, in the absence of a general good faith doctrine, are the common law rules on mistake and misrepresentation, duress (including economic duress) and undue influence, the objective interpretation of contracts, the concept of unconscionability, implied terms, waiver and estoppels.”* [43].

Applebey also strongly advocate that *“English Contract Law already has good faith by applying notions in other ways or using other doctrines.”*[44]. This has been proven in *Blackpool and Fylde Aero Club v. Blackpool Borough Council* [45] and *Fairclough Building Ltd v. Port Talbot Borough Council* [46].

In short, the principle of good faith is a subjective statement which evens a legally defined Act like in Australia still encounters difficulty to interpret it consistently. So far, there is no specific concept of the good faith that can be defined both by the courts and scholars [47].

Perhaps, Cooter and Schafer have a better idea to handle the issue:

“In fact, the civil codes of contracts are not inherently formal or informal, or flexible or inflexible. Civil codes contain precise rule and

also general rules. By stressing precise rules, courts can decide cases informally and inflexibly. By stressing general rules like good faith, courts can decide cases informally and flexibly.” [48].

Conclusion

Clearly, the current position of the English Law still does not recognize the principle of good faith. Thus no implied duty will be construed for any contracting party to negotiate. However, where the term is expressly drafted by professional lawyers which includes the liabilities of breaching the term, the duty to negotiate in good faith is then will be binding. This resulted vagueness in the English Law whenever interpreting of this rule as compare to other jurisdictions throughout the world which already adopted it. The situation had been commented by McKendrick as follow:

“While the objection based on the uncertainty of an obligation to negotiate in good faith can be applied to express and implied terms, it can be said to carry less weight in the context of an expressly assumed obligation to negotiate in good faith because it is trumped by the argument based on freedom of contract” [49].

However, if the underlying challenges of the ‘implied’ term are clearly defined the judges will be able to give validity to an agreement more easily. Hence, in line with the EC Unfair Terms in Consumer Contracts Regulation 1999 [50] the English courts should recognize the principle of good faith as a legal doctrine.

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